

Date

January 21, 1994

To

Robert E. Norton, Jr.

From

Anne Connelly

Subject

American Express

Copies To

Alex W. "Pete" Hart

Peter S.P. Dimsey

F. David Brangaccio



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Memorandum

- No other card should be possible
- Own collection of issues
 - Information DWD - at this point
 - position: Banks are not to
 - This is a new by some nation
- Further - how much is it worth?
- Further - how much is it worth?

The prospect of American Express (AMEX) participating in a MasterCard co-branding program or other issuing arrangement presents a number of issues that, in the case of Dean Witter, either were not encountered at all, or, in view of the court decision against Visa, were determined not to override the membership's compelling interest in a total release from legal liability. The scope of these card competitors' activities, as well as the contexts in which their co-branding proposals have arisen, differ significantly. While the structure of the Dean Witter program can serve as a template for American Express, we should be prepared to address the key areas in which the board and the membership are likely to distinguish between the two co-branding decisions:

Context for Co-branding

What precedent, if any, was set by the approval of the NationsBank application to co-brand with Dean Witter Discover (DWD)? I think the DWD precedent is "without a big lawsuit, we refuse competitors" because:

The NationsBank/DWD co-branding program was approved in the context of settling a lawsuit that exposed (at least U.S.) members to substantial potential monetary damages. At issue in the DWD lawsuits is whether a membership association may determine and control the composition of its membership: MasterCard's position was that it, in its "sole judgment," determines membership eligibility and controls brand licensing. The Dean Witter settlement begged the question of controlling membership, but the implication is that MasterCard allowed a competitor's co-branding arrangement in consideration for the settlement. The NationsBank/DWD co-branding program is widely viewed as the quid pro quo for DWD's agreement not to pursue damages against members; the lesser evil (vs. immediate membership for DWD); and a justifiable result given the alternatives.

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Obviously the rationale behind the DWD decision does not apply to AMEX. The fact that DWD is already a co-branding partner does not seem to provide a strong basis for a similar decision involving AMEX; nor does the threat of potential litigation by AMEX: the 10th Circuit decision against Visa and the amount of potential damages there were precipitating factors in our DWD co-branding decision; no analogy exists for AMEX. The liability was real in the case of DWD but it is not with AMEX.

The "precedent" set by the DWD resolution can be interpreted in two ways, but they conflict:

MasterCard competitors will be accorded the same consideration as other entities not eligible for membership through co-branding arrangements,
or,

MasterCard will vigorously resist card competitors and will not enter into co-branding arrangements with direct competitors except in exchange for a uniquely compelling benefit to the membership.

The way we choose to apply "precedent" -- by discriminating or not discriminating against direct competitors--will be interpreted as indicative of our conclusions about an association's right to determine and control its membership.

Scope of Activities

DWD operations are within the U.S.; AMEX's (TRS) scope is global and parallels that of MasterCard: 70% U.S. and 30% outside the U.S. From the point of view of the global board in considering DWD, once the legal liability was contained within the U.S. region, the non-U.S. members (and directors) were insulated from the consequences of any outcome--membership, co-branding, continued litigation, etc.

The AMEX situation will present the first instance in which non-U.S. directors will consider an arrangement involving an in-market competitor. This may be mitigated somewhat if the applications are confined to the U.S. Region, but the applications could involve other regions more directly.

American Express Bank, Ltd. (the "international platform for supporting the TRS business globally") has formed "strategic alliances" with Banco Nacional de Mexico and Banco Santander to develop and market new card products. (The directors from these members could view the anticipated arrangement as preempting or diminishing their existing programs.) American Express Bank, Ltd. could be the applicant outside the U.S., or in the priority region not served by strategic alliances, (i.e., Asia/Pacific), with a co-branding program serving the purpose, for the time being, in the U.S.

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Leveling the Playing Field

To the extent that our own efforts and Visa's long-standing positioning against the American Express card are viewed as having successfully diminished AMEX's market position, how will we explain giving AMEX a hand when it's down? If AMEX were to benefit from a MasterCard program, Visa would claim that its significant investment in its positioning against AMEX had been severely undermined by the MasterCard action. Dual members would be told that their Visa programs had been impaired.

While many banks seem to be far less focused on AMEX as a competitor than Visa because of their activities with American Express Travelers Cheques and ATM acceptance of the American Express card, we should remember that these activities are marginally profitable, commodity-esque fee opportunities, whereas the credit card business--to our value-oriented issuers--is core and highly differentiable.

AMEX wants distribution--an established mass market product and 8 million more acceptance locations (everywhere they want to be). We have "proprietary account access" designed for telephone companies but ideal for co-branders who really want to cross-sell their own card products and provide second to none acceptance at minimal cost. At what point do we draw the line between payment services co-branders and non-financial co-branders?

Conclusion

Attachment I attempts to compare the DWD and AMEX situations in order to structure an AMEX result most consistent with the DWD outcome.

The "quid" is critical. Here are some possible quids:

- AMEX buys or co-brands our travelers cheque program
- MasterCard gets access to AMEX travel services offices and emergency card/cash replacement
- MasterCard gets an exclusive with AMEX
- BankOne pays a higher assessment on cards issued under the program

Distinguishing between competitor and non-competitor co-branding partners is important. We need to avoid the downside of duality. Divided loyalties lead to the uncontrollable sharing of MasterCard's proprietary information with Visa. We must act to insulate MasterCard from developing the same problem with competitor co-branding partners.

AC/lc

Attachment

ATTACHMENT I

	<u>Dean Witter Discover</u>	<u>American Express</u>
Background	<ul style="list-style-type: none"> • Dean Witter Discover (DWD) sues Visa but not MasterCard; • DWD prevails against Visa; • Visa decision determined to be relevant to MasterCard/DWD situation; • MasterCard negotiates compromise 	<ul style="list-style-type: none"> • American Express (AMEX) picks up with MasterCard where DWD left off, without involving Visa
MasterCard's Response to Affiliated Bank's Membership Application	<ul style="list-style-type: none"> • Refuse approval; bring and defend litigation; • Defer decision indefinitely • Compromise via co-branding <u>after Visa decision</u> 	<ul style="list-style-type: none"> • Just say "no" defend, if sued • Outcome of Visa litigation is irrelevant basis for deferring AMEX decision
Competitive Issues Raised	<ul style="list-style-type: none"> • Competitor's activities limited to U.S. region 	<ul style="list-style-type: none"> • Competitor's scope of activity is global • Is there a difference between co-branding with a competitor and co-branding with a non-competitor?
Legal Risk	<ul style="list-style-type: none"> • Injunctive action plus threat of substantial monetary damages to J.S. Reg on members 	<ul style="list-style-type: none"> • Injunctive action; possibly globally, little or no threat of monetary damages
Context: Surrounding Decision on Co-branding Program	<ul style="list-style-type: none"> • Settlement of all DWD claims v. MasterCard and MasterCard members 	<ul style="list-style-type: none"> • "Precedent" - a competitor (DWD) already has a co-branding program or, • Just say "no" or, • Obtain <u>quid pro quo</u> with unique benefits: entry fee?, exclusivity? travelers check, travel office deal?

Dean Witter DiscoverAmerican Express

Limitations on Co-branding Program

- | | | |
|---------------|---|--|
| • Issuer | • Member having no affiliation with co-branding partner | SAME |
| • Application | • Filed and processed by issuing member | SAME |
| • Receivables | • >50% issuer owned | SAME |
| • Marketing | • Use of DWD indicia ("Discover," "Novus") prohibited | • Use of AMEX indicia - Optima (as brand), Centurion: name, logo, blue box, etc. prohibited
• May be impracticable to down-grade Optima from brand to program name--would require card reissuance, new graphics, removing POS signage, etc. |

MasterCard Board Issues

- | | |
|---|--|
| • Financial and competitive impact restricted to U.S. directors | • Impact is global |
| • Substantial effort (mgmt. & board) invested over one-year+ in resisting issuance by direct competitor | • Banco Santander, Bank Nacional de Mexico have "new card" strategic alliances with American Express Bank Ltd. |
| • Outside counsel served as advisor to board | • Risk of "saying no" seems small
• DWD counsel has conflict with AMEX |